SUPREME COURT, U. S.

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IN THE

# Supreme Court of the United States

October Term, 1968

No. 1215

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL and AQUITAINE COMPANY OF CANADA LTD.,

*Petitioners,*

*against*

DAVID H. SCHOENBAUM,

*Respondent.*

## BRIEF FOR PLAINTIFF-RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

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## BRIEF FOR PLAINTIFF-RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

Plaintiff-Respondent submits this brief in opposition to the petition for certiorari of defendants Manley, Pradal, Rudolph, Russell, and Aquitaine Company of Canada, Ltd. (Aquitaine). The petition seeks review of an *en banc* decision of the Court of Appeals for the Second Circuit (405 F. 2d 215), which granted reargument and upon reargument set aside, in part, a prior panel decision (405 F. 2d 200), reversed a judgment of the District Court for the Southern District of New York which dismissed the complaint (268 F. Supp. 385), and remanded the case for trial.

### Questions Presented

1. Do the anti-fraud provisions of the Securities Exchange Act of 1934 (Exchange Act) protect stockholders

of a Canadian corporation whose shares, predominantly owned by United States citizens (Pet. p. 12), are listed on the American Stock Exchange?

2. Is an admitted use of the mails and the facilities of a national securities exchange sufficient to confer jurisdiction upon the District Court to determine whether the anti-fraud provisions of the Exchange Act have been violated?

3. Is a purchase by a controlling shareholder of stock directly from the corporation at a grossly inadequate price, and at a time when it, and not the public, knows of material inside information affecting the price of the securities, a fraud and deception upon the corporation and its shareholders?

## Statement of Facts

### A. The Parties

Plaintiff is a shareholder in Banff Oil Ltd. (Banff) (1).* He commenced this stockholders' derivative action on its behalf. Banff is a Canadian corporation with its principal offices located at 550 Sixth Avenue, S. W., Calgary, Alberta, (149). It is engaged in the business of exploration for and production of oil and gas (149). At all relevant times, Banff's common stock has been registered, listed and traded on the American Stock Exchange (150).

Defendant Aquitaine is a Canadian corporation. Aquitaine is and was at all relevant times Banff's controlling shareholder, owning at least 40% of its common stock (160). Aquitaine acquired its controlling interest in Banff pursuant to a tender offer made to Banff shareholders on January 15, 1964 (43-44). The tender offer was jointly managed by the New York banking firm of Lehman Brothers and the Montreal firm of Greenshields Incorpo-

* Numbers in brackets refer to pages of the record.

rated (34). After the tender offer was completed, Aquitaine placed three representatives on Banff's board of directors (160).

**B. Banff's Exploration Activities**

In October, 1964, Banff and Aquitaine entered into an agreement with Socony-Mobil relating to 160,000 acres of Crown reservation land located in the Rainbow lake area of Northwestern, Alberta, Canada (44). The agreement provided that Banff and Aquitaine were to obtain a 50% interest in the land in exchange for drilling two exploratory wells (44). Shortly thereafter, it became apparent that the exploration activities were successful (60). Final confirmation came on March 17, 1965, when tests revealed that the wells contained "oil and gas pay . . . amongst the thickest ever encountered in the province of Alberta" (3-4).

The law of Alberta permits a company engaged in exploration activities to withhold reservoir content information for one year (55-56). During the year, no oil or gas can be produced from the exploratory wells but leases on adjacent Crown Land are open for bidding (55). The company with knowledge of the reservoir content on its test wells enjoys a distinct competitive advantage in the ensuing bidding (56).

Banff availed itself of its privilege of non-disclosure. From March 17, 1965 to March 16, 1966, it did not divulge reservoir content information; though it did disclose other information (60-61).

On March 16, 1966, it issued a press release which, in pertinent part, stated as follows:

> "Today marks the end of one year since the completion of drilling of the Banff Aquitaine Rainbow West 7-32-109-8 W. 6 discovery to a depth of 7,236 feet.
>
> * * *

Following the discovery, successful oil wells were drilled and completed in Lsd. 12-33, three-quarters of a mile northeast, and in Lsd. 10-32, one quarter of a mile north of the discovery. The three wells have been designated the Railbow 'A' pool by the Oil and Gas Conservation Board.

* * *

The total Keg River reef oil and gas pay of 686 feet in the discovery well is amongst the thickest ever encountered in the Province of Alberta and its discovery has stimulated a sharply expanded exploration program in northwest Alberta, northeast British Columbia and the Northwest Territories (3-4)."

**C. The Aquitaine Purchase of Treasury Stock**

The total actual cost of drilling the exploratory wells was $775,000 (52) of which Banff was obligated to pay 10%, or $77,500 (51). The board, after purportedly considering alternative methods, decided on December 10, 1964 to raise $77,500—Banff's share of the exploratory cost—by selling 500,000 shares of treasury stock to Aquitaine at $1.35 per share, or an aggregate price of $675,000 (52-53). No explanation was given for offering $675,000 worth of stock in order to raise $77,500. Aquitaine tentatively accepted the offer on January 5, 1965 (66). The closing took place on March 16, 1965, (160) the day before exploration activities were completed.

Aquitaine knew of the success of Banff's exploration activities; the investing public would have to wait one year to obtain this information. The purchase price paid by Aquitaine was $1.35 per share, the current market price (52-53). This price did not reflect Banff's successful, but as yet undisclosed, activities in the Rainbow area. A year later, after full disclosure had been made, Banff's stock

traded on the American Stock Exchange at a high of $18 (151). Thus, an investment of $675,000 grew, in one year, to $9,000,000, an appreciation of 13,000%.

**D. Prior Proceedings**

Promptly after the action was commenced, defendants moved for summary judgment. Based on self-serving affidavits, they attempted to establish that Aquitaine's purchase was not made on inside information, that the resulting 13,000% appreciation was merely fortuitous, and that, in any event, subject matter jurisdiction was lacking because the transaction took place outside the United States and had no impact within the United States. The district court credited the affidavits, denied plaintiff's request for discovery, and dismissed the complaint holding that it lacked subject matter jurisdiction and that the complaint failed to state a claim for relief. On appeal, the court held that the district court had subject matter jurisdiction but affirmed on the ground that no substantive claim was set forth, because defendants' affidavits, which were uncontested, established the absence of fraud and deception.

Plaintiff sought reargument. He contended that he was unable to answer defendants' affidavits because he had been denied discovery and all the relevant evidence was in the exclusive possession of the defendants. Reargument was granted on that issue and, on reargument, the court held:

> "The district court's grant of summary judgment against the plaintiff was acompanied by a refusal of his request for discovery. This court has indicated that summary judgment should rarely be granted against a plaintiff in a stockholder's derivative action especially when the plaintiff has not had an opportunity to resort to discovery procedures [cases omitted]. The plaintiff typically has in his possession only the facts which he alleges in his complaint.

> Having little or no familiarity with the internal affairs of the corporation, he is faced with affidavits setting forth in great detail management's version of what actions were taken and what motives led the affiant to take these actions. Since the facts in such a case are exclusively in the possession of the defendants, summary judgment should not ordinarily be granted where the facts alleged by the plaintiff provide a ground for recovery, at least not without allowing discovery in order to provide plaintiff the possibility of counteracting the effect of defendants' affidavits."
>
> 405 F. 2d at 218.

The Court accordingly remanded the case to the District Court for further proceedings.

The present record contains a complaint, answers, and defendants' affidavits and exhibits giving their version of the facts. Plaintiff believes that the issues are not sufficiently important to merit review. But, if they are, then review should await the conclusion of the trial so that they may be determined on a complete record.

## Reasons for Denying the Petition

### I

### An Interlocutory Order Should Not Be Reviewed, Except Under Exceptional Circumstances Not Present in This Case

A non-final judgment should not be reviewed, except to avert extraordinary inconvenience and embarassment. See *American Construction Co.* v. *Jacksonville Tampa and Key West Railway Co.*, 148 U. S. 372, 384 (1893); *United States* v. *Beatty*, 232 U. S. 463 (1914); See *Di Bella* v. *United States*, 369 U. S. 121 (1962).

The reason for the policy is clear. Subsequent events may make non-final orders moot as the facts, developed in an adversary proceeding, may present completely different issues. Defendants have not set forth any reason why an immediate review is necessary.

## II

### The Exchange Act Can Have Extra-Territorial Application

In an effort to create an important issue, defendants contend that the Exchange Act does not apply to the challenged transaction because it was accomplished outside the boundaries of the United States. This contention was rejected by all ten circuit court judges. That the Exchange Act can have extra-territorial application is so clear from an analysis of the act itself and relevant case law, as to render the issue of little importance.

Congress announced its intention to extend the protection of the Exchange Act to foreign transactions in the very title of the Act:

> "An Act To provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and *foreign* commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes" (emphasis added), 48 Stat. 881.

Section 2 of the Exchange Act, 15 U. S. C. 78b, which sets forth the necessity for regulation, refers continually to the need for protecting "interstate commerce"; this is defined by Section 3(a)(17), 15 U. S. C. 78c(a)(17), to include "trade, commerce, transportation, or communication . . . *between any foreign country and any State,* or between any State and any place or ship outside thereof" (emphasis added). Congress had the power both under

the Constitution and under the law of nations to legislate with respect to foreign transactions affecting securities markets within the United States and American investors. See, *e.g.*, *Ford* v. *United States*, 273 U. S. 593, 619-624 (1927); *United States* v. *Pizzarusso*, 388 F. 2d 8 (2d Cir., 1968); *United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 443-444 (2d Cir., 1945). As this Court has held with respect to the extra-territorial jurisdiction of particular states, "Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if [the actor] had been present at the [time of the detrimental] effect, if the state should succeed in getting him within its power." *Strassheim* v. *Dailey*, 221 U. S. 280, 285 (1911). No reason has been shown why Congress would not have wanted to utilize this broad power. The Exchange Act was, after all, intended to "be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U. S. 180, 195 (1963); see *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967). And, as a later Congress noted, "[I]n principle U. S. investors in foreign securities ought to be afforded the same protections as are provided for investors in domestic securities." S. Rep. No. 379, 88th Cong., 1st Sess. (1963), p. 29.

Defendants, apparently conceding that the district court can assume jurisdiction over a foreign transaction, provided that the transaction has an impact within the United States, contend that the sale of the 500,000 shares had no such impact. They argue that there is no impact because the shares cannot be traded here as they "would not constitute valid delivery of Banff's tax-exempt stock on purchases executed on the [American Stock] Exchange"

(Pet. p. 13). But if the shares were sold for an inadequate consideration, then Banff's shareholders, who are predominantly United States citizens (Pet. p. 12), suffered a heavy dilution of their equity interest. Defendants conveniently ignore this impact.

Finally, defendants contend that even if the Exchange Act can otherwise apply to them, they are exempted from its provisions by §30(b) (15 USC §78dd(b)). That section provides as follows:

> "The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title."

The exemption applies only to persons engaged in the securities business, such as brokers, dealers and lenders. It has no application to isolated securities transactions by non-professionals. The reason for the exemption is to free the Securities and Exchange Commission (SEC) from regulating foreign securities markets and foreign brokers, dealers and lenders, unless, in the opinion of the SEC, such regulation becomes necessary. The exemption does not apply to the defendants in this case who do not "transact a business in securities," but engaged in an isolated transaction. The very fact that Congress found it necessary to exempt certain persons raises an inference that others are not exempt.

## III

## The District Court Has Jurisdiction to Determine the Violation Alleged

### a) The mails and facilities of a national securities exchange were admittedly used

Defendants admit that the mails and the facilities of a national securities exchange were present but they contend that their use was not essential to the accomplishment of the violation alleged. It has long been settled under the mail fraud statute (in which the use of the mails is the gist of the violation) that an incidental use of the mails is sufficient. *Durland* v. *United States*, 161 U. S. 306, 315 (1896). The same reasoning applies *a fortiori* to the Exchange Act. See 3 Loss, *Securities Regulations*, pp. 1519-1528 (2 ed., 1961). No court has ever held that the corpus delicti of an exchange act violation is the use of the mails.

### b) Fraud and deception are present whenever a fiduciary over-reaches in a trade with his cestui que trust

Defendants also contend that the *en banc* decision of the Second Circuit seems to eliminate the element of fraud or deception as an ingredient in a §10(b) case. The argument overlooks the fact that an act may be fraudulent when a fiduciary relationship is involved even though the same act, in an arm's-length transaction, would not be fraudulent. *Securities & Exchange Commission* v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963). In *Capital Gains*, the defendant urged that the SEC had failed to prove fraud or deception. This Court, in rejecting that argument, held:

> "Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit

against a party to an arm's-length transaction. Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." 375 U. S. at 194.

## Conclusion

The decision rendered in this case has none of the far-reaching aspects attributed to it by defendants. It simply reaffirms a well-established rule that defendants who have exclusive possession of the evidence, cannot obtain summary judgment simply by swearing that they did no wrong. Plaintiff must first be given access to the information. See *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U. S. 464 (1962); *Kennedy* v. *Silas Mason Co.*, 334 U. S. 249 (1948).

**It is respectfully submitted that the petition for certiorari should be denied.**

Respectfully submitted,

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April 28, 1969.